

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of Alternative Regulatory
Frameworks of Local Exchange Carriers.

Investigation 87-11-033
(Filed November 25, 1987)

**ADMINISTRATIVE LAW JUDGE'S RULING
AUTHORIZING THE FILING OF SUPPLEMENTS
TO APPLICATIONS FOR REHEARING**

On February 17, 2000, the Commission issued Decision (D.) 00-02-047. This decision granted the petition for modification filed by Pacific Bell on June 10, 1999 requesting, among other things, a transfer of the responsibility for the audit ordered of Pacific Bell from the Commission's Office of Ratepayer Advocates (ORA) to the Commission's Telecommunications Division.

A joint application for rehearing was subsequently filed by ORA and The Utility Reform Network (TURN) addressing various items contained in D.00-02-047. The resolution of the rehearing request has been pending before the Commission awaiting a final decision.

It has recently been determined that due to an oversight in the manner in which certain agenda materials were distributed, that the document distributed to the parties and the public as D.00-02-047 was not, in fact, the draft decision that was before the Commission when it voted on February 17, 2000. The version before the Commission which was adopted contained several pages of textual differences from the document identified as D.00-02-047. This version had been

mailed to parties on January 21, 2000, prior to the meeting at which the Commission voted.

The textual differences include some additional discussion of decision rationale and an assessment of the comments received on the proposed decision. Correspondingly, it includes some findings of fact, conclusions of law, and ordering paragraphs not found in the document distributed as D.00-02-047. The dissents noted are unchanged.

A copy of the document that was before the Commission and should have been distributed as D.00-02-047 accompanies this ruling in two versions. One is the straight text as would appear in a signed and issued decision. The other is a “red-lined” version that highlights the textual differences for the convenience of the parties.

In order to address this problem, parties to this proceeding will be given 30 days (the full statutory time pursuant to Pub. Util. C. § 1731), until November 3, 2000 to file a supplement to their previously filed application for rehearing. In the event no prior application for rehearing was filed, but a party believes error exists in the portions of the decision that were not part of the document distributed as D.00-02-047, those parties can file their initial application for rehearing. Responses to applications for rehearing are governed by the Commission's Rules of Practice and Procedure and not by statute. Since the supplements or initial applications for rehearing are limited in their scope, pursuant to Rule 87 a deviation will be granted from the time specified in Rule 86.2 to give parties until November 10, 2000 to file responses to any filed supplements or initial applications for rehearing complying with this ruling.

Any supplements or initial applications for rehearing filed with respect to the enclosed order are to address only the textual differences and not the

discussion, findings, conclusions or ordering paragraphs that remain unchanged. The only exception will be any allegation of error that deals with the relationship between the textual changes and the originally distributed text, e.g., an inconsistency among the original and changed sections of the order.

While this supplemental application for rehearing process is taking place, the decision on rehearing currently on the Commission's decision-making agenda will be withdrawn from the agenda until the supplemental rehearing process is completed and any review and account can be taken of any filings made in that process.

THEREFORE, IT IS RULED that:

1. On or before November 3, 2000, parties may file a supplement to their application for rehearing of D.00-02-047 or an initial application for rehearing if no prior application for rehearing was filed.
2. The scope of any supplement or initial application for rehearing filed in response to this ruling shall be limited to the changes in text that are indicated and not the discussion, findings, conclusions or ordering paragraphs that remain unchanged. The only exception will be any allegation of error that deals with the relationship between the textual changes and the originally distributed text, e.g., an inconsistency among the original and changed sections of the order.
3. On or before November 10, 2000, responses to any supplements or initial applications for rehearing that conform to this ruling may be filed.

Dated October 4, 2000, at San Francisco, California.

/s/ PHILIP SCOTT WEISMEHL

Philip Scott Weismehl
Administrative Law Judge

Decision 00-02-047 February 17, 2000

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DECISION GRANTING PETITION FOR MODIFICATION

Summary

The June 10, 1999 Petition for Modification of Decision (D.) 94-06-011 filed by Pacific Bell requesting reassignment of oversight responsibility for a compliance audit from the Office of Ratepayer Advocates (ORA) to the Telecommunications Division is granted. We concur with the assessment of the Executive Director's letter of August 6, 1999 that the scope of the audit proposed by ORA failed to comply with the orders in D.96-05-036.

The audit oversight responsibility is reassigned from the Office of Ratepayer Advocates (ORA) to the Telecommunications Division. The Telecommunications Division is directed to ensure that the audit scope includes the modifications identified by the Executive Director's letter of August 6, 1999.

The existing or future oversight of other audits by ORA is not hereby precluded.

Procedural Background

On June 10, 1999, Pacific Bell filed a Petition for Modification of D.94-06-011 (Petition). Pacific Bell requests modification to the effect that the audit of Pacific Bell's books and records required by D.94-06-011 be undertaken by the Commission's Telecommunications Division rather than by ORA. Pacific Bell concurrently filed an Emergency Motion requesting the Assigned

Commissioner, Executive Director or the Administrative Law Judge (ALJ) suspend the awarding of the auditing contract under a request for proposal (RFP) issued by ORA. ORA filed a Response to the Emergency Motion on June 16, 1999.

On July 7, 1999, Assigned Commissioner Duque and ALJ Weismehl issued a Joint Ruling. The Joint Ruling directed the Executive Director to meet with the responsible ORA managers to ascertain the status of the audit contract documents and to ensure that the audit conforms with the Commission's adopted requirements and otherwise satisfies all necessary state contracting procedures. It indicated that upon confirmation that the audit conforms with our decisions, an order would be brought before the full Commission denying the Petition. If the Executive Director were to determine that the audit plan fails to conform to prior decisions, an order would be brought before the full Commission to remedy the situation directly or through reassignment. Finally, the Joint Ruling denied the Emergency Motion.

In response to the Joint Ruling, the Executive Director undertook his review and reported back to the Commission and to the parties by letter dated August 6, 1999. The Executive Director set forth three areas in which the audit plan failed to conform to the Commission's instructions. The Executive Director also recommended that the audit oversight be reassigned from ORA to the Telecommunications Division.

On August 17, 1999, ORA filed a Motion requesting an order denying the Petition. In the Motion, ORA agreed to the audit scope modification recommendations of the Executive Director and urged that the audit oversight responsibility be retained by ORA.

Timeliness of the Petition for Modification

While filed more than one year after the effective date of the decision, the Petition is timely nevertheless. Rule 47(d) of the Commission's Rules of Practice and Procedure permits a late filing where, as here, there is an explanation as to "why the petition could not have been presented within one year of the effective date of the decision."

Pacific Bell could not have presented the Petition earlier because it only recently obtained the information which forms the basis for the Petition, such as the details of ORA's RFP and the Overland Consulting (Overland) Proposal. It is this new information which prompted Pacific Bell to renew its objections to the audit scope, the format of the audit process along with the propriety of ORA and its contractors to conduct the audit. (Petition p. 3 - 4; Emergency Motion, p. 2 - 3.) That Pacific Bell previously requested the audit reassignment does not mean that it possessed or we considered these facts at the time of the initial petition and our initial review. Moreover, the emergence of these new facts provided a factual basis for Pacific to renew its request via the Petition within one year of the decision's effective date, our normal timetable for the filing of petitions.

As discussed below, reassignment is sought based on the substantiation of certain conflicts of interest or bias on the part of ORA. The alleged conflict evidenced by ORA's auditor selection only became apparent in June 1999, when Pacific Bell obtained a copy of the Overland Proposal. It was at this time that Pacific Bell first became aware of Overland's subcontract with Dr. Lee Selwyn. As detailed below, Dr. Selwyn testifies against Pacific Bell on behalf of its competitors in Commission proceedings. The alleged conflict of ORA's audit plan also became more evident in April 1999, when Pacific Bell first obtained a copy of the RFP. The RFP is alleged to demonstrate the excessive scope of the

ORA audit and that the audit is not “independent,” as required by D.96-05-036. (Emergency Motion, p. 8.)

Pursuant to Rule 47, Pacific Bell has adequately explained why the Petition could not have been presented within one year of the effective date of the decision. We therefore reach the merits of the Petition.

Scope of the Audit

Among the objections raised by Pacific Bell is that ORA is not undertaking the audit in conformance with the requirements we imposed as to scope and management of the audit consultant contract. We address these objections before considering the reassignment of the audit oversight responsibility. Whether ORA or the Telecommunications Division oversees the audit, it is essential that the scope correspond to the directions of the Commission.

The subject audit requirements are set forth in D.96-05-036.¹ Pacific Bell alleges that the RFP issued by ORA goes beyond the authorization set forth in D.96-05-036, and argues that the Executive Director lacks the authority to modify D.96-05-036. We concur that the audit must conform to the D.96-05-036 requirements absent any subsequent Commission decision altering these requirements.

¹D.96-05-036 states in pertinent part: “The services we are authorizing DRA to procure are limited to an in-depth audit, on an account-by-account basis, with all appropriate, detailed follow-up. The resulting work product should include an analysis of all issues uncovered, including any relevant documentation. This work product should not include lengthy policy discussions. The Commission seeks accurate and fully supported factual analysis. Recommendations as to specific accounting measures would also be welcome. “

In response to our Joint Ruling, the Executive Director identified three areas in which the audit plan failed to conform to the Commission's instructions. The Executive Director states:

"First, ORA proposes to look at the sale of Bellcore and the merger between Pacific Bell's parent company, SBC and Ameritech. The Bellcore transaction was the subject of a settlement between ORA and Pacific Bell, and is therefore not an appropriate area of review. Second, the merger of SBC and Ameritech. Because this transaction is not complete, and there is no application before this Commission at this time, it does not fit within the prescribed timeframe of the audit (1996-1998). Third, ORA's RFP states that: 'The contractor will be expected to interview, in addition to personnel at Pacific Bell and its affiliates, personnel from other regulatory agencies, and other interested parties to establish their perspective on PacBell's affiliate transactions and non-structural safeguards.' (Emphasis in original.) Interviewing competitors of Pacific Bell is not an appropriate part of this audit. Pacific Bell's competitors will have ample opportunity in the next NRF review to raise allegations of anti-competitive conduct by Pacific Bell.

With the exception of the three areas I have described above, the scope of the audit plan conforms with the Commission's directives." (August 6, 1999 Letter of Executive Director at A.)

At pages 2-3 of the Motion requesting denial of the Petition, ORA discusses and agrees to each modification recommended by the Executive Director. With these modifications, we are confident that the scope more closely conforms to our prior decisions regardless of whether ORA or the Telecommunications Division oversees the audit.

In its comments on this matter, ORA responds that the Executive Director is mistaken in his description of the audit scope. Of the three areas of excessive scope identified by the Executive Director, ORA claims that two were included in the Overland Proposal but not the ORA RFP. ORA does not dispute that the

third area was included in its RFP. ORA argues that it complied with the Commission's audit directives because the Overland Proposal is not part of the audit plan. ORA states "these items were not included in ORA's RFP or otherwise included in ORA's audit plan. Instead, as discussed above, these items were merely contained in the consultant's proposal that, by the terms of the RFP, is not the final work plan." (ORA Comments, p.5).

ORA's response does not address the fact that the Overland Proposal is incorporated by reference in the audit contract to set forth the audit scope, including the hours, rates and specific work to be performed. The "Standard Agreement" between Overland and ORA for consulting services provides "That the Contractor . . . does hereby agree to furnish to the State services and materials as follows: (Set forth service . . . and *attach plans and specifications*, if any.)" (Italics added.) The Standard Agreement then expressly incorporates by reference the "RFP/Contractor's Proposal" and attaches it as an appendix.

We then note that the \$1.3 million audit contract contains only a two page general audit description absent the details and terms in the incorporated Overland Proposal. Even if not a part of ORA's RFP, as ORA contends, the terms are included by reference in the contract signed by ORA on the Commission's behalf. Thus, they constitute a key element of the work agreement between ORA and its vendor. It is therefore clear that the Executive Director's inference, that the scope of the work exceeds that envisioned by the Commission, is a reasonable conclusion.

Pacific Bell also submits comments concerning the failure of the scope of the audit to conform to Commission decisions. In particular, it points out that in the winning proposal, which is part of the signed contract:

“only a small portion of total hours to be devoted to clearly identifiable audit work. Out of a total estimated 9,500 hours of work and cost in excess of \$1 million, less than 4% of total hours are clearly identifiable as audit work designed to determine whether books and records are being maintained in compliance with rules and regulations.” (Pacific Comments, p. 7.)

This provides perhaps the firmest quantitative evidence that the scope of the audit has expanded beyond that of the compliance audit envisioned in D.96-05-036.

Pacific’s Comments further note that D.98-10-019 orders the audit pursuant to Public Utilities Code § 314.5 (books and records). Pacific notes that in reaching this result that Commission rejected an ALJ proposed decision that would have made this audit subject to P.U. Code § 797 (affiliate transactions) as well. Pacific points out that the winning RFP nevertheless allots 58% of total consulting time to the analysis of affiliate relations, a figure clearly inconsistent with the Commission’s order. Further, the RFP allocates another 30% of the time to cost allocations within the wireline business. This scope of audit makes little sense for a company subject to price cap regulation and for which “profit sharing” no longer is in effect.

Request for Reassignment

In requesting reassignment, Pacific Bell alleges that ORA is furthering its own adversarial interests under the guise of an “independent” audit. Pacific Bell claims that ORA’s selection of Overland as auditor belies any claim of “independence” or “objectivity.” (Emergency Motion, p. 7.) Pacific Bell also cites ORA’s legislative mandate in Public Utilities Code § 309.5 to advocate ratepayer

interests. Irrespective of the legislative mandate,² we find that the factual predicate exists for the appearance of bias in the continued audit oversight by ORA.

To begin with, the Commission “take[s] very seriously allegations of bias and pre-judgment.” (Re Pacific Telesis Group (1994) 53 CPUC 2d 344, 347.) It is important not only that fairness in the Commission’s process be maintained, but also that the proceedings be conducted in such a manner as to avoid the suspicion of unfairness, and, if possible, inspire public confidence and trust. The entire audit process is to be independent in fact as well as appear to be independent.

We have expressed a deep concern that an objective and impartial audit be conducted in accordance with Pub. Util. Code § 314.5. Among other things, we ordered ORA “to engage an independent certified public accountant who lacks any real or *apparent conflicts of interest*.” (D.96-05-039, p. 9.) (Italics added.) We reiterated that “the need for independence is critical to the audit.” (*Id.* at p. 10.)

Similarly, professional accounting standards³ require that the auditor be “without bias” and maintain total impartiality. (1 AICPA Professional Standards at § 220.02.) An auditor must remain “free of conflicts of interest.” (2 AICPA Professional Standards at § 54.02, 55.01.) “Independent auditors should not only be independent in fact; they should avoid situations that may lead outsiders to doubt their independence.” (1 AICPA Professional Standards at § 220.03.)

² We are not unmindful of Pacific Bell’s concerns: “[U]nlike earlier days when Commission staff was neutral, and appeared to “develop the record” to guide the ALJ and Commission, today RRB is an advocacy unit for the ratepayers, and *its product is subject to the same group interest and advocacy bias as is that of the applicant utility*.” (D.99-03-032.) (Italics added.)

³ Of course, Overland is not bound by these standards. Overland employs and subcontracts with CPAs but is not registered with a state board of accountancy like a CPA firm.

For these reasons, the appearance of bias – those circumstances leading a reasonable person to doubt the impartiality – is both a sufficient and compelling ground for reassignment of the audit oversight. Reassignment is not taken lightly or on mere allegations, however. The unilateral perception of bias by Pacific Bell or any party is not a ground for reassignment. For the Commission to hold otherwise would encourage parties to raise the specter of bias or conflicts of interest indiscriminately.

With respect to ORA's oversight, the appearance of bias is demonstrated by the details of the plan that have emerged through the auditor selection process. In particular, the accepted Overland Proposal contains a subcontract with Economics and Technology, Inc., with Dr. Selwyn as a technical advisor. Dr. Selwyn has served as an advocate against Pacific Bell on behalf of ORA and has been employed by its competitors, AT&T and MCI Worldcom.

We take official notice of the undisputed content of the ORA RFP along with the Overland Proposal, which includes the Selwyn subcontract. (*See* Rule 73.) We take official notice of Dr. Selwyn's testimony on behalf of AT&T and MCI Worldcom in proceedings wherein Pacific Bell was also a party, D.98-12-079, D.97-08-059, D.97-04-090, D.96-10-066, and D.96-03-020. D.98-12-079, in particular, involved NRF issues. We also take official notice of Dr. Selwyn's testimony against Pacific Bell on behalf of ORA in D.97-03-067.

When a consultant consistently advocates on behalf of the same clients, a perception may arise that he is predisposed not only to a particular point of view but also to a bias in favor of his clients and, correspondingly, against the entity cast in the opposing role. We are not suggesting that a consultant or ORA, for that matter, must be indifferent on the general subject matter of an audit. For example, we have stated that bias “‘in the sense of a crystallized point of view

about issues of the law or policy’” is not a ground for disqualification of ALJs. (D.97-04-089.) Yet reassignment is appropriate where the potential or perceived bias against a party is sufficient to impair either the independence of the audit or the perception of its independence. Indeed, the choice of such a conflicted consultant to conduct an independent audit would appear unwise.

Our concerns are further magnified by the continued problems with the scope of the audit proposed by ORA. It was only after Pacific Bell filed its Emergency Motion and Petition that ORA agreed to amend the scope of the audit. We had rejected ORA’s initial audit plan for lack of specificity and outlined the scope in D.96-05-036. Thus, ORA had two chances to propose an independent audit consistent with our decisions. It would thus appear that a bias exists here sufficient to impair the independence of this audit.

We do not find that Pacific Bell has demonstrated actual bias on the part of ORA. Our staff, ORA as well as the Telecommunications Division, are highly trained and carry out their assigned duties in a professional manner. Indeed, as summarized by the Executive Director:

“The question is not about ORA’s integrity, competence or whether Overland is independent or without conflict of interest. It is about the objectivity, and perception of objectivity, of ORA and Overland as responsible for the audit.” (August 6, 1999 Executive Director Letter, p. 3.)

However, despite the staff professionalism, the pattern of ORA’s non-compliance with Commission directives in this specific matter raises an appearance of bias in the management of this audit that ORA cannot now remedy.

Under the circumstances, an adequate remedy does not exist other than reassignment of the audit oversight to the Telecommunications Division. Given

the complexity and scope of this audit, subtle but nonetheless unfair direction and other influences attributable to potential ORA bias could not always be recognized, challenged or remedied on an administrative record. The Commission cannot repeatedly intervene in the management of an audit process. For these reasons, we concur with the Executive Director's assessment that the best managerial strategy to ensure compliance with the Commission's decisions concerning this matter is the reassignment of audit responsibility from ORA.

There are a number of factors in place to ensure independent oversight by the Telecommunications Division. The Telecommunications Division has no stake in a particular outcome of this audit. In fact, the Telecommunications Division is the only entity which has no financial or other interest in the outcome except to fulfill its duties assigned by the Commission. When or if valid objections are raised to the audit findings and recommendations, we are confident that the Telecommunications Division can maintain its objectivity in advising the Commission.

While the Alternate questions the propriety of a Telecommunications Division audit, similar audits conducted by the Energy Division in R.94-04-031/I.94-04-032 and A.98-09-003/A.98-09-008 provide precedent and procedural guidance. Pursuant to a schedule to be determined by the ALJ, the Telecommunications Division shall file and serve the audit report. The retained consultants and the Telecommunications Division staff shall also make themselves available for cross-examination by ORA and/or Pacific Bell.

While the Commission agrees with the need to avoid the appearance of impropriety, "we understand that the state contracting process can be cumbersome" (D.96-05-036, p. 10.) Audits would ideally be overseen and conducted by completely objective third party entities and individuals. We

recognize, however, that the availability of Commission staff and the universe of qualified outside consultants for audits is limited.

This decision in no way precludes the existing or future oversight of *other* audits by ORA, such as the GTEC and Roseville audits. The Commission declines to cast that cloud of uncertainty over existing and future audits. We simply require that minimization of bias and the appearance of bias be significant criteria controlling the oversight of audits.

Comments on the Draft Decision

We received comments on the draft decision from ORA, The Utility Reform Network (TURN) and Utility Consumers' Action Network (UCAN) and Pacific Bell. We received reply comments from ORA and Pacific.

ORA raises several points in its comments concerning the law and the facts before the Commission. First, ORA argues that the Petition must be resolved under the procedures set forth in Pub. Util. Code § 309.5(e). ORA's reliance on Pub. Util. Code § 309.5(e) is completely misplaced. By its own terms, Section 309.5(e) only addresses requests by ORA to compel information from utilities. A Petition to Modify by Pacific Bell clearly is not an ORA request to compel discovery. Neither is a request to reassign an audit for bias even remotely discovery related.

Second, in its reply comments, ORA states that the Commission has not ordered an "objective" audit. ORA continues to ignore the Commission's order that the audit be "independent" or, in other words, objective. ORA further ignores that its own RFP required the audit to be "performed objectively." (ORA Opening Comments, p. 3.) This, unfortunately, is the heart of the issue that the Commission faces and demonstrates the necessity for reassigning the audit oversight.

Third, ORA asserts that there is no record evidence supporting the finding of an appearance of bias in the audit oversight. ORA is wrong. Record evidence supports our appearance of bias finding. In its Emergency Motion, Pacific Bell had documented that Overland's track record belies any claim of 'independence'" even before ORA awarded the contract. (Emergency Motion, p. 7.) This was despite the fact that ORA had not yet awarded the audit contract to Overland. The Commission may also officially notice the content of Overland Proposal, including the Selwyn subcontract, along with consultant testimony in its proceedings. The nexus between ORA, Overland and Selwyn is clear. In its reply comments, Pacific Bell points out that the Executive Director concluded after a review of these facts that "I simply do not believe that in its oversight role it [ORA] could remain neutral or be perceived as neutral."⁴ It is clear that ORA's actions create the appearance of bias.

Finally, ORA quotes Andrews v. ALRB, 28 Cal.3d 781 for the proposition that appearance of bias is never a ground for judicial disqualification. Yet Andrews also states that the "appearance of bias can be a ground for removal of a judge . . ." (*Id.* at p. 791, n. 4.) Moreover, the actual bias ground cited in Andrews was changed by the Legislature in 1984:

"The new statute altered the requirement by making the disqualification standard 'fundamentally an objective one. It represents a legislative judgment that due to the sensitivity of the question and inherent difficulties of proof as well as the importance of public confidence in the judicial system, the issue is not limited to

⁴ Letter of Executive Director dated August 6, 1999 in response to the Joint Ruling of the Assigned Commissioner and ALJ, p. 3.

the existence of actual bias.’” (Catchpole v. Brannon (1995) 36 Cal.App.4th 237, 246.)

Thus, once again we have a failure of ORA to appreciate the importance that the Commission attaches to the objectivity of the audit. Moreover, ORA’s comments and pleadings in response to this Petition demonstrate that the results of an audit conducted consistent with the principles espoused would have diminished probative value.

TURN also provided comments that address the appearance of bias issue. It is important to reiterate that in D.96-05-039, the Commission emphasized that “the need for independence is critical to the audit.” (D.96-05-039, p. 10.) That “independence” comes down to a question of public perception. It follows then that an “independent” audit should be conducted in a manner so as to avoid even the appearance of bias.

TURN then comments that we fail to specify a “yardstick for explaining” the appearance of bias. (TURN Comments, p. 2.) Few, if any, standards are defined to that point of complete certitude desired by TURN. TURN ignores the inherent difficulty of defining a state of mind such as bias. It would be virtually impossible for the PD to list the many conceivable factors which might create the appearance of bias. Bias or the appearance of bias is seldom, if ever, defined so completely that reasonable persons might not still disagree.

Contrary to TURN, we set forth a workable standard for ascertaining the appearance of bias in this particular proceeding where we have taken great pains to specify that this is an independent audit and that:

“DRA⁵ should engage an independent certified public accountant who lacks any *real or apparent* conflicts of interest with the last two years and or for a reasonable time in the future, with the utility in question or its affiliates.” (D. 96-05-036.)

The subjective charge of bias alone is insufficient for reassignment. We have required the party requesting reassignment to set forth legally sufficient facts to demonstrate bias or the appearance of bias. The party must set forth concrete facts. Bias is never implied – facts are presented. In addition to the excessive audit scope, Pacific has established a twenty-year history on the part of a subcontractor of appearing as a witness in opposition to this specific company and on behalf of its competitors.

Similarly, TURN comments that today’s order is “not based on a realistic appraisal of the market for auditors.” (TURN Comments, p. 1.) TURN fails to understand that we do not equate the absence of bias with complete indifference to the subject matter of the audit. Rather, we acknowledge that the “the availability of Commission staff and the universe of outside consultants for audits is limited.” We reiterate that an expressed or “crystallized” view on auditing issues, in and of itself, is not a ground for reassignment. By contrast, we conclude that the close alignment of a subcontractor with the competitors of Pacific Bell for over twenty years is indicative of more than a “crystallized” view on auditing. Indeed, we believe the only reasonable conclusion is that there is an apparent bias.

The comments and replies of Pacific have been addressed at the relevant point in the text of this decision.

⁵ ORA was formerly DRA.

Conclusion

By this decision, we transfer the audit oversight responsibility from ORA to the Telecommunications Division. The audit scope is also to comply with the modifications identified by the Executive Director's August 6, 1999 letter. We leave the continued retention of Overland for this audit to the sound discretion of the Telecommunications Division.

Findings of Fact

1. On June 10, 1999, Pacific Bell filed Petition seeking modification to reassign the audit oversight responsibility from ORA to the Telecommunications Division.
2. Pacific Bell could not have filed the Petition within one year of the Decision's effective date because it only recently obtained the information which forms the basis of the Petition, such as the ORA RFP and the Overland Proposal.
3. The Commission rejected ORA's initial audit plan and outlined the audit scope in D.96-05-036.
4. The Overland Proposal is incorporated by reference in the audit contract signed by the Commission.
5. The Overland Proposal identifies only 4 percent of the total hours as audit work.
6. The Overland Proposal allocates 58 percent of total consulting time to the analysis of affiliate relations.
7. Our review confirms the audit scope findings of the Executive Director set forth in his August 6, 1999 letter. We agree with the Executive Director's identification of three areas in which the audit plan fails to conform to the Commission's instructions.

8. After Pacific Bell filed its Petition, ORA filed a Motion requesting an order denying the Petition wherein ORA agreed to the audit scope modifications recommended by the Executive Director.

9. The Overland Proposal accepted by ORA contains a subcontract with Economics and Technology, Inc., which includes Dr. Lee Selwyn as a technical advisor.

10. In Commission proceedings, Dr. Selwyn has testified on behalf of ORA and the competitors of Pacific Bell, AT&T, and MCI Worldcom.

11. Circumstances exist here which would lead a reasonable person to doubt the impartiality of the continued audit oversight by ORA.

12. The Telecommunications Division has no financial or other interest in the outcome of the audit, except to fulfill its duties assigned by the Commission.

Conclusions of Law

1. Pursuant to Rule 47, the Petition is timely.

2. D.96-05-039 required that ORA engage an independent certified accountant lacking any real or apparent conflict of interest.

3. The audit contract services incorporated by reference to the Overland Proposal are inconsistent with an audit performed pursuant to Pub. Util. Code § 314.5.

4. The entire audit process is to be independent in fact as well as appear to be independent.

5. Reassignment of the audit oversight responsibility is appropriate because there is an appearance of bias sufficient to impair the independence of the audit.

6. The appearance of bias is demonstrated by the auditor selection process and the recurrent problems with the audit scope.

7. Pacific Bell has not demonstrated actual bias on the part of ORA.

8. An adequate remedy does not exist here other than reassignment of the audit oversight to the Telecommunications Division.

9. The continued retention of Overland and/or Dr. Selwyn for this audit is left to the discretion of the Telecommunications Division.

10. The existing or future oversight of other audits by ORA is not precluded.

11. The existing or future engagement of Overland and/or Dr. Selwyn for other audits is not precluded.

O R D E R

1. The New Regulatory Framework audit ordered by Decision (D.) 94-06-011 shall be undertaken by the Telecommunications Division. The Office of Ratepayer Advocates shall not have any responsibilities for contractor selection or oversight of this audit.

2. The audit scope shall be modified to reflect the changes in scope recommended by the Executive Director's letter of August 6, 1999.

3. The June 10, 1999 Petition for Modification of D.94-06-011 filed by Pacific Bell is granted as set forth in this order.

4. The ALJ is to set forth a schedule concerning the filing and service of the audit report. The Telecommunications Division shall file and serve the audit report in accordance with that schedule. The retained consultants and the

Telecommunications Division staff shall also make themselves available for cross-examination by ORA and/or Pacific Bell.

This order is effective today.

Dated February 17, 2000, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners

I will file a dissent.

/s/ CARL W. WOOD
Commissioner

I will file a dissent.

/s/ LORETTA M. LYNCH
Commissioner

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The audit oversight responsibility is reassigned from the Office of Ratepayer Advocates (ORA) to the Telecommunications Division. The Telecommunications Division is directed to ensure that the audit scope includes the modifications identified by the Executive Director's letter of August 6, 1999.

The existing or future oversight of other audits by ORA is not hereby precluded.

Procedural Background

On June 10, 1999, Pacific Bell filed a Petition for Modification of D.94-06-011 (Petition). Pacific Bell requests modification to the effect that the audit of Pacific Bell's books and records required by D.94-06-011 be undertaken by the Commission's Telecommunications Division rather than by ORA. Pacific Bell concurrently filed an Emergency Motion requesting the Assigned Commissioner, Executive Director or the Administrative Law Judge (ALJ) suspend the awarding of the auditing contract under a request for proposal (RFP) issued by ORA. ORA filed a Response to the Emergency Motion on June 16, 1999.

On July 7, 1999, Assigned Commissioner Duque and ALJ Weismehl issued a Joint Ruling. The Joint Ruling directed the Executive Director to meet with the responsible ORA managers to ascertain the status of the audit contract documents and to ensure that the audit conforms with the Commission's adopted requirements and otherwise ~~meet~~satisfies all necessary state contracting procedures. It indicated that upon confirmation that the audit conforms with our decisions, an order would be brought before the full Commission denying the Petition. If the Executive Director were to determine that the audit plan fails to conform to prior decisions, an order would be brought before the full Commission to remedy the situation directly or through reassignment. Finally, the Joint Ruling denied the Emergency Motion.

In response to the Joint Ruling, the Executive Director undertook his review and reported back to the Commission and to the parties by letter dated August 6, 1999. The Executive Director set forth three areas in which the audit plan failed to conform to the Commission's instructions. The Executive Director also recommended that the audit oversight be reassigned from ORA to the Telecommunications Division.

On August 17, 1999, ORA filed a Motion requesting an order denying the Petition. In the Motion, ORA agreed to the audit scope modification recommendations of the Executive Director and urged that the audit oversight responsibility be retained by ORA.

Timeliness of the Petition for Modification

While filed more than one year after the effective date of the decision, the Petition is timely nevertheless. Rule 47(d) of the Commission's Rules of Practice and Procedure permits a late filing where, as here, there is an explanation as to "why the petition could not have been presented within one year of the effective date of the decision."

Pacific Bell could not have presented the Petition earlier because it only recently obtained the information which forms the basis for the Petition, such as the details of ORA's RFP and the Overland Consulting (Overland) Proposal. It is this new information which prompted Pacific Bell to renew its objections to "the audit scope, the ~~objectivity and~~ format of the audit ~~process, and process~~ along with the propriety of ORA and its contractors" to conduct the audit.

(7/12/99 Pacific Bell Letter, p. 2.)(Petition p. 3 - 4; Emergency Motion, p. 2 - 3.)

That Pacific Bell previously requested the audit reassignment does not mean that it possessed or we considered these facts at the time of the initial petition and our initial review. Moreover, the emergence of these new facts ~~precluded~~provided a factual basis for Pacific to renew its request via the Petition within one year of the decision's effective date, our normal timetable for the filing of petitions.

As discussed below, reassignment is sought based on the substantiation of certain conflicts of interest or bias on the part of ORA. The alleged conflict evidenced by ORA's auditor selection only became apparent in June 1999, when Pacific Bell obtained a copy of the Overland Proposal. It was at this time that

Pacific Bell first became aware of Overland's subcontract with Dr. Lee Selwyn. As detailed below, Dr. Selwyn testifies against Pacific Bell on behalf of its competitors in Commission proceedings. The alleged conflict of ORA's audit plan also became more evident in April 1999, when Pacific Bell first obtained a copy of the RFP. The RFP is alleged to demonstrate the excessive scope of the ORA audit and that the audit is not "independent," as required by D.96-05-036. (Emergency Motion, p. 8.)

Pursuant to Rule 47, Pacific Bell has adequately explained why the Petition could not have been presented within one year of the effective date of the decision. We therefore reach the merits of the Petition.

Scope of the Audit

Among the objections raised by Pacific Bell is that ORA is not undertaking the audit in conformance with the requirements we imposed as to scope and management of the audit consultant contract. We address these objections before considering the reassignment of the audit oversight responsibility. Whether ORA or the Telecommunications Division oversees the audit, it is essential that the scope correspond to the directions of the Commission.

The subject audit requirements are set forth in D.96-05-036.⁶ Pacific Bell alleges that the RFP issued by ORA goes beyond the authorization set forth in D.96-05-036, and argues that the Executive Director lacks the authority to modify D.96-05-036. We concur that the audit must conform to the D.96-05-036

¹ D.96-05-036 states in pertinent part: "The services we are authorizing DRA to procure are limited to an in-depth audit, on an account-by-account basis, with all appropriate, detailed follow-up. The resulting work product should include an analysis of all issues uncovered, including any relevant documentation. This work product should not include lengthy policy

Footnote continued on next page

requirements absent any subsequent Commission decision altering these requirements.

In response to our Joint Ruling, the Executive Director identified three areas in which the audit plan failed to conform to the Commission's instructions. The Executive Director states:

"First, ORA proposes to look at the sale of Bellcore and the merger between Pacific Bell's parent company, SBC and Ameritech. The Bellcore transaction was the subject of a settlement between ORA and Pacific Bell, and is therefore not an appropriate area of review. Second, the merger of SBC and Ameritech. Because this transaction is not complete, and there is no application before this Commission at this time, it does not fit within the prescribed timeframe of the audit (1996-1998). Third, ORA's RFP states that: 'The contractor will be expected to interview, in addition to personnel at Pacific Bell and its affiliates, personnel from other regulatory agencies, and other interested parties to establish their perspective on PacBell's affiliate transactions and non-structural safeguards.' (Emphasis in original.) Interviewing competitors of Pacific Bell is not an appropriate part of this audit. Pacific Bell's competitors will have ample opportunity in the next NRF review to raise allegations of anti-competitive conduct by Pacific Bell.

"With the exception of the three areas I have described above, the scope of the audit plan conforms with the Commission's directives." (August 6, 1999 Letter of Executive Director at A.)

At pages 2-3 of the Motion requesting denial of the Petition, ORA discusses and agrees to each modification recommended by the Executive Director. With these modifications, we are confident that the scope ~~new~~more

discussions. The Commission seeks accurate and fully supported factual analysis. Recommendations as to specific accounting measures would also be welcome. "

closely conforms to our prior decisions regardless of whether ORA or the Telecommunications Division oversees the audit.

In its comments on this matter, ORA responds that the Executive Director is mistaken in his description of the audit scope. Of the three areas of excessive scope identified by the Executive Director, ORA claims that two were included in the Overland Proposal but not the ORA RFP. ORA does not dispute that the third area was included in its RFP. ORA argues that it complied with the Commission's audit directives because the Overland Proposal is not part of the audit plan. ORA states "these items were not included in ORA's RFP or otherwise included in ORA's audit plan. Instead, as discussed above, these items were merely contained in the consultant's proposal that, by the terms of the RFP, is not the final work plan." (ORA Comments, p.5).

ORA's response does not address the fact that the Overland Proposal is incorporated by reference in the audit contract to set forth the audit scope, including the hours, rates and specific work to be performed. The "Standard Agreement" between Overland and ORA for consulting services provides "That the Contractor . . . does hereby agree to furnish to the State services and materials as follows: (Set forth service . . . and *attach plans and specifications*, if any.)" (Italics added.) The Standard Agreement then expressly incorporates by reference the "RFP/Contractor's Proposal" and attaches it as an appendix.

We then note that the \$1.3 million audit contract contains only a two page general audit description absent the details and terms in the incorporated Overland Proposal. Even if not a part of ORA's RFP, as ORA contends, the terms are included by reference in the contract signed by ORA on the Commission's behalf. Thus, they constitute a key element of the work agreement between ORA and its vendor. It is therefore clear that the Executive Director's inference,

that the scope of the work exceeds that envisioned by the Commission, is a reasonable conclusion.

Pacific Bell also submits comments concerning the failure of the scope of the audit to conform to Commission decisions. In particular, it points out that in the winning proposal, which is part of the signed contract:

“only a small portion of total hours to be devoted to clearly identifiable audit work. Out of a total estimated 9,500 hours of work and cost in excess of \$1 million, less than 4% of total hours are clearly identifiable as audit work designed to determine whether books and records are being maintained in compliance with rules and regulations.” (Pacific Comments, p. 7.)

This provides perhaps the firmest quantitative evidence that the scope of the audit has expanded beyond that of the compliance audit envisioned in D.96-05-036.

Pacific’s Comments further note that D.98-10-019 orders the audit pursuant to Public Utilities Code § 314.5 (books and records). Pacific notes that in reaching this result that Commission rejected an ALJ proposed decision that would have made this audit subject to P.U. Code § 797 (affiliate transactions) as well. Pacific points out that the winning RFP nevertheless allots 58% of total consulting time to the analysis of affiliate relations, a figure clearly inconsistent with the Commission’s order. Further, the RFP allocates another 30% of the time to cost allocations within the wireline business. This scope of audit makes little sense for a company subject to price cap regulation and for which “profit sharing” no longer is in effect.

Request for Reassignment

In requesting reassignment, Pacific Bell alleges that ORA is furthering its own adversarial interests under the guise of an “independent” audit. Pacific Bell

claims that ORA's selection of Overland as auditor belies any claim of "independence" or "objectivity." (Emergency Motion, p. 7.) Pacific Bell also cites ORA's legislative mandate in Public Utilities Code § 309.5 to advocate ratepayer interests. Irrespective of the legislative mandate,⁷ we find that the factual predicate exists for the appearance of bias in the continued audit oversight by ORA.

To begin with, the Commission "take[s] very seriously allegations of bias and pre-judgment." (Re Pacific Telesis Group (1994) 53 CPUC 2d 344, 347.) It is important not only that fairness in the Commission's process be maintained, but also that the proceedings be conducted in such a manner as to avoid the suspicion of unfairness, and, if possible, inspire public confidence and trust. The entire audit process is to be independent in fact as well as appear to be independent.

We have expressed a deep concern that an objective and impartial audit be conducted in accordance with Pub. Util. Code § 314.5. Among other things, we ordered ORA "to engage an independent certified public accountant who lacks any real or *apparent conflicts of interest*." (D.96-05-039, p. 9.) (Italics added.) We reiterated that "the need for independence is critical to the audit." (*Id.* at p. 10.)

Similarly, professional accounting standards⁸ require that the auditor be "without bias" and maintain total impartiality. (1 AICPA Professional Standards at § 220.02.) An auditor must remain "free of conflicts of interest." (2 AICPA

² We are not unmindful of Pacific Bell's concerns: "[U]nlike earlier days when Commission staff was neutral, and appeared to "develop the record" to guide the ALJ and Commission, today RRB is an advocacy unit for the ratepayers, and *its product is subject to the same group interest and advocacy bias as is that of the applicant utility*." (D.99-03-032.) (Italics added.)

³ Of course, Overland is not bound by these standards. Overland employs and subcontracts with CPAs but is not registered with a state board of accountancy like a CPA firm.

Professional Standards at § 54.02, 55.01.) “Independent auditors should not only be independent in fact; they should avoid situations that may lead outsiders to doubt their independence.” (1 AICPA Professional Standards at § 220.03.)

For these reasons, the appearance of bias – those circumstances leading a reasonable person to doubt the impartiality – is both a sufficient and compelling ground for reassignment of the audit oversight. Reassignment is not taken lightly or on mere allegations, however. The unilateral perception of bias by Pacific Bell or any party is not a ground for reassignment. For the Commission to hold otherwise would encourage parties to raise the specter of bias or conflicts of interest indiscriminately.

With respect to ORA’s oversight, the appearance of bias is demonstrated by the details of the plan that have emerged through the auditor selection process. In particular, the accepted Overland Proposal contains a subcontract with Economics and Technology, Inc., with Dr. Selwyn as a technical advisor. Dr. Selwyn has served as an advocate against Pacific Bell on behalf of ORA and has been employed by its competitors, AT&T and MCI Worldcom.

We take official notice of the undisputed content of the ORA RFP along with the Overland Proposal, which includes the Selwyn subcontract. (See Rule 73.) We take official notice of Dr. Selwyn’s testimony on behalf of AT&T and MCI Worldcom in proceedings wherein Pacific Bell was also a party, D.98-12-079, D.97-08-059, D.97-04-090, D.96-10-066, and D.96-03-020. ~~(See Rule 73.)~~ D.98-12-079, in particular, involved NRF issues. We also take official notice of Dr. Selwyn’s testimony against Pacific Bell on behalf of ORA in D.97-03-067.

When a consultant consistently advocates on behalf of the same clients, a perception may arise that he is predisposed not only to a particular point of view but also to a bias in favor of his clients and, correspondingly, against the entity cast in the opposing role. We are not suggesting that a consultant or ORA, for

that matter, must be indifferent on the general subject matter of an audit. For example, we have stated that bias “in the sense of a crystallized point of view about issues of the law or policy” is not a ground for disqualification of ALJs. (D.97-04-089.) Yet reassignment is appropriate where the potential or perceived bias against a party is sufficient to impair either the independence of the audit or the perception of its independence. Indeed, the choice of such a conflicted consultant to conduct an independent audit would appear unwise.

Our concerns are further magnified by the continued problems with the scope of the audit proposed by ORA. It was only after Pacific Bell filed its Emergency Motion and Petition that ORA agreed to amend the scope of the audit. We had rejected ORA’s initial audit plan for lack of specificity and outlined the scope in D.96-05-036. Thus, ORA had two chances to propose an independent audit consistent with our decisions. It would thus appear that a bias exists here sufficient to impair the independence of this audit.

We do not find that Pacific Bell has demonstrated actual bias on the part of ORA. Our staff, ORA as well as the Telecommunications Division, are highly trained and carry out their assigned duties in a professional manner. Indeed, as summarized by the Executive Director:

“The question is not about ORA’s integrity, competence or whether Overland is independent or without conflict of interest. It is about the objectivity, and perception of objectivity, of ORA and Overland as responsible for the audit.” (August 6, 1999 ~~Letter of~~ Executive Director ~~at~~ Letter, p. 3.)

~~Nevertheless, despite the professionalism of ORA’s staff,~~ However, despite the staff professionalism, the pattern of ORA’s ~~sef~~ non-compliance with Commission directives in this specific matter raises an appearance of bias in the management of this audit that ORA cannot now ~~repair~~ remedy.

Under the circumstances, an adequate remedy does not exist other than reassignment of the audit oversight to the Telecommunications Division. Given the complexity and scope of this audit, subtle but nonetheless unfair direction and other influences attributable to potential ORA bias could not always be recognized, challenged or remedied on an administrative record. The Commission cannot repeatedly intervene in the management of an audit process. For these reasons, we concur with the Executive Director's assessment that the best managerial strategy to ensure compliance with the Commission's decisions concerning this matter is the reassignment of audit responsibility from ORA.

~~By contrast, there~~There are a number of factors in place to ensure independent oversight by the Telecommunications Division. The Telecommunications Division has no stake in a particular outcome of this audit. In fact, the Telecommunications Division is the only entity which has no financial or other interest in the outcome except to fulfill its duties assigned by the Commission. When or if valid objections are raised to the audit findings and recommendations, we are confident that the Telecommunications Division can maintain its objectivity in advising the Commission.

While the Alternate questions the propriety of a Telecommunications Division audit, similar audits conducted by the Energy Division in R.94-04-031/I.94-04-032 and A.98-09-003/A.98-09-008 provide precedent and procedural guidance. Pursuant to a schedule to be determined by the ALJ, the Telecommunications Division shall file and serve the audit report. The retained consultants and the Telecommunications Division staff shall also make themselves available for cross-examination by ORA and/or Pacific Bell.

While the Commission agrees with the need to avoid the appearance of impropriety, "we understand that the state contracting process can be cumbersome" (D.96-05-036, p. 10.) Audits would ideally be overseen and

conducted by completely objective third party entities and individuals. We recognize, however, that the availability of Commission staff and the universe of qualified outside consultants for audits is limited.

This decision in no way precludes the existing or future oversight of *other* audits by ORA, such as the GTEC and Roseville audits. The Commission declines to cast that cloud of uncertainty over existing and future audits. We simply require that minimization of bias and the appearance of bias be significant criteria controlling the oversight of audits.

Conclusion-Comments on the Draft Decision

We received comments on the draft decision from ORA, The Utility Reform Network (TURN) and Utility Consumers' Action Network (UCAN) and Pacific Bell. We received reply comments from ORA and Pacific.

ORA raises several points in its comments concerning the law and the facts before the Commission. First, ORA argues that the Petition must be resolved under the procedures set forth in Pub. Util. Code § 309.5(e). ORA's reliance on Pub. Util. Code § 309.5(e) is completely misplaced. By its own terms, Section 309.5(e) only addresses requests by ORA to compel information from utilities. A Petition to Modify by Pacific Bell clearly is not an ORA request to compel discovery. Neither is a request to reassign an audit for bias even remotely discovery related.

Second, in its reply comments, ORA states that the Commission has not ordered an "objective" audit. ORA continues to ignore the Commission's order that the audit be "independent" or, in other words, objective. ORA further ignores that its own RFP required the audit to be "performed objectively." (ORA Opening Comments, p. 3.) This, unfortunately, is the heart of the issue that the Commission faces and demonstrates the necessity for reassigning the audit oversight.

Third, ORA asserts that there is no record evidence supporting the finding of an appearance of bias in the audit oversight. ORA is wrong. Record evidence supports our appearance of bias finding. In its Emergency Motion, Pacific Bell had documented that Overland's track record belies any claim of 'independence' even before ORA awarded the contract. (Emergency Motion, p. 7.) This was despite the fact that ORA had not yet awarded the audit contract to Overland. The Commission may also officially notice the content of Overland Proposal, including the Selwyn subcontract, along with consultant testimony in its proceedings. The nexus between ORA, Overland and Selwyn is clear. In its reply comments, Pacific Bell points out that the Executive Director concluded after a review of these facts that "I simply do not believe that in its oversight role it [ORA] could remain neutral or be perceived as neutral."⁹ It is clear that ORA's actions create the appearance of bias.

Finally, ORA quotes Andrews v. ALRB, 28 Cal.3d 781 for the proposition that appearance of bias is never a ground for judicial disqualification. Yet Andrews also states that the "appearance of bias can be a ground for removal of a judge . . ." (Id. at p. 791, n. 4.) Moreover, the actual bias ground cited in Andrews was changed by the Legislature in 1984:

"The new statute altered the requirement by making the disqualification standard 'fundamentally an objective one. It represents a legislative judgment that due to the sensitivity of the question and inherent difficulties of proof as well as the importance of public confidence in the judicial system, the issue is not limited to the existence of actual bias.'" (Catchpole v. Brannon (1995) 36 Cal.App.4th 237, 246.)

⁴ Letter of Executive Director dated August 6, 1999 in response to the Joint Ruling of the Assigned Commissioner and ALJ, p. 3.

Thus, once again we have a failure of ORA to appreciate the importance that the Commission attaches to the objectivity of the audit. Moreover, ORA's comments and pleadings in response to this Petition demonstrate that the results of an audit conducted consistent with the principles espoused would have diminished probative value.

TURN also provided comments that address the appearance of bias issue. It is important to reiterate that in D.96-05-039, the Commission emphasized that "the need for independence is critical to the audit." (D.96-05-039, p. 10.) That "independence" comes down to a question of public perception. It follows then that an "independent" audit should be conducted in a manner so as to avoid even the appearance of bias.

TURN then comments that we fail to specify a "yardstick for explaining" the appearance of bias. (TURN Comments, p. 2.) Few, if any, standards are defined to that point of complete certitude desired by TURN. TURN ignores the inherent difficulty of defining a state of mind such as bias. It would be virtually impossible for the PD to list the many conceivable factors which might create the appearance of bias. Bias or the appearance of bias is seldom, if ever, defined so completely that reasonable persons might not still disagree.

Contrary to TURN, we set forth a workable standard for ascertaining the appearance of bias in this particular proceeding where we have taken great pains to specify that this is an independent audit and that:

"DRA¹⁰ should engage an independent certified public accountant who lacks any *real or apparent* conflicts of interest with the last two years and or for a reasonable time in the future, with the utility in question or its affiliates." (D. 96-05-036.)

⁵ ORA was formerly DRA.

The subjective charge of bias alone is insufficient for reassignment. We have required the party requesting reassignment to set forth legally sufficient facts to demonstrate bias or the appearance of bias. The party must set forth concrete facts. Bias is never implied – facts are presented. In addition to the excessive audit scope, Pacific has established a twenty-year history on the part of a subcontractor of appearing as a witness in opposition to this specific company and on behalf of its competitors.

Similarly, TURN comments that today's order is "not based on a realistic appraisal of the market for auditors." (TURN Comments, p. 1.) TURN fails to understand that we do not equate the absence of bias with complete indifference to the subject matter of the audit. Rather, we acknowledge that the "the availability of Commission staff and the universe of outside consultants for audits is limited." We reiterate that an expressed or "crystallized" view on auditing issues, in and of itself, is not a ground for reassignment. By contrast, we conclude that the close alignment of a subcontractor with the competitors of Pacific Bell for over twenty years is indicative of more than a "crystallized" view on auditing. Indeed, we believe the only reasonable conclusion is that there is an apparent bias.

The comments and replies of Pacific have been addressed at the relevant point in the text of this decision.

Conclusion

By this decision, we transfer the audit oversight responsibility from ORA to the Telecommunications Division. The audit scope is also to comply with the modifications identified by the Executive Director's August 6, 1999 letter. We leave the continued retention of Overland for this audit to the sound discretion of the Telecommunications Division.

Findings of Fact

1. On June 10, 1999, Pacific Bell filed Petition seeking modification to reassign the audit oversight responsibility from ORA to the Telecommunications Division.

2. Pacific Bell could not have filed the Petition within one year of the Decision's effective date because it only recently obtained the information which forms the basis of the Petition, such as the ORA RFP and the Overland Proposal.

3. The Commission rejected ORA's initial audit plan and outlined the audit scope in D.96-05-036.

4. The Overland Proposal is incorporated by reference in the audit contract signed by the Commission.

5. The Overland Proposal identifies only 4 percent of the total hours as audit work.

6. The Overland Proposal allocates 58 percent of total consulting time to the analysis of affiliate relations.

7. Our review confirms the audit scope findings of the Executive Director set forth in his August 6, 1999 letter. We agree with the Executive Director's identification of three areas in which the audit plan fails to conform to the Commission's instructions.

8. After Pacific Bell filed its Petition, ORA filed a Motion requesting an order denying the Petition wherein ORA agreed to the audit scope modifications recommended by the Executive Director.

9. The Overland Proposal accepted by ORA contains a subcontract with Economics and Technology, Inc., which includes Dr. Lee Selwyn as a technical advisor.

10. In Commission proceedings, Dr. Selwyn has testified on behalf of ORA and the competitors of Pacific Bell, AT&T, and MCI Worldcom.

11. Circumstances exist here which would lead a reasonable person to doubt the impartiality of the continued audit oversight by ORA.

12. The Telecommunications Division has no financial or other interest in the outcome of the audit, except to fulfill its duties assigned by the Commission.

Conclusions of Law

1. Pursuant to Rule 47, the Petition is timely.

2. D.96-05-039 required that ORA engage an independent certified accountant lacking any real or apparent conflict of interest.

3. The audit contract services incorporated by reference to the Overland Proposal are inconsistent with an audit performed pursuant to Pub. Util. Code § 314.5.

4. The entire audit process is to be independent in fact as well as appear to be independent.

5. Reassignment of the audit oversight responsibility is appropriate because there is an appearance of bias sufficient to impair the independence of the audit.

6. The appearance of bias is demonstrated by the auditor selection process and the recurrent problems with the audit scope.

7. Pacific Bell has not demonstrated actual bias on the part of ORA.

8. An adequate remedy does not exist here other than reassignment of the audit oversight to the Telecommunications Division.

9. The continued retention of Overland and/or Dr. Selwyn for this audit is left to the discretion of the Telecommunications Division.

10. The existing or future oversight of other audits by ORA is not precluded.

11. The existing or future engagement of Overland and/or Dr. Selwyn for other audits is not precluded.

O R D E R

1. The New Regulatory Framework audit ordered by Decision (D.) 94-06-011 shall be undertaken by the Telecommunications Division. The Office of Ratepayer Advocates shall not have any responsibilities for contractor selection or oversight of this audit.

2. The audit scope shall be modified to reflect the changes in scope recommended by the Executive Director's letter of August 6, 1999.

3. The June 10, 1999 Petition for Modification of D.94-06-011 filed by Pacific Bell is granted as set forth in this order.

4. The ALJ is to set forth a schedule concerning the filing and service of the audit report. The Telecommunications Division shall file and serve the audit report in accordance with that schedule. The retained consultants and the

Telecommunications Division staff shall also make themselves available for cross-examination by ORA and/or Pacific Bell.

This order is effective today.

Dated February 17, 2000, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners

I will file a dissent.

/s/ CARL W. WOOD
Commissioner

I will file a dissent.

/s/ LORETTA M. LYNCH
Commissioner

**(SEE CPUC FORMAL FILES FOR A COPY OF
COMRS. WOOD'S AND LYNCH'S DISSENTS.)**

CERTIFICATE OF SERVICE

I certify that I have by mail this day served a true copy of the original attached Administrative Law Judge's Ruling Authorizing the Filing of Supplements to Applications for Rehearing on all parties of record in this proceeding or their attorneys of record.

Dated October 4, 2000, at San Francisco, California.

/s/ TERESITA C. GALLARDO
Teresita C. Gallardo

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

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